

Office of Chief Counsel  
Internal Revenue Service

**memorandum**

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TJFernandez

**AUG 19 2002**

date:

to: Anthony Llopart, Tax Compliance Officer, Laguna Niguel

from: Area Counsel, Small Business/Self-Employed Division, Laguna Niguel  
Edwin A. Herrera, Associate Area Counsel, SB/SE Group 3  
Thomas J. Fernandez, Attorney

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subject: Deductibility of Japanese FICA under I.R.C. § 164  
Year: [REDACTED]

DISCLOSURE STATEMENT

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

This memorandum is in response to your request for advice with respect to the above-referenced issue.<sup>1</sup>

**ISSUE**

Whether Japanese nationals who are simultaneously employees of [REDACTED] and [REDACTED] may deduct the employee portion of payments made into the Japanese pension system pursuant to I.R.C. § 164 while they are employed in the U.S. and living in the U.S.

**CONCLUSION**

There is not enough information to make a determination on this issue. [REDACTED], (b)(7)a

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<sup>1</sup> All of the facts set forth in this opinion were obtained from Mr. Lopart and some documents provided by him. We have made no independent investigation of the facts in this case. Our legal conclusions may change if the actual facts are different than the facts represented to us by Mr. Llopart. For instance, we assume that you have confirmed that the payments were actually withheld from the employees, paid for insurance, and that the amounts paid were included in the income of the employees.

(b)(7)a

(b)(7)a

### FACTS

The taxpayers, [REDACTED] Japanese nationals employed as [REDACTED] for [REDACTED], work in the U.S. for a limited time. The taxpayers are classified as resident aliens for federal income tax purposes.<sup>2</sup> At all times, the taxpayers are also employees of [REDACTED], the parent company of [REDACTED]. As employees of [REDACTED], the taxpayers are making contributions to the Japanese pension system. Such contributions are based on a percentage of each individuals wages and are for the benefit of employees against old age, disability and death. The payments are made by [REDACTED] but the taxpayers income is grossed up to account for the payments being made on their behalf. The taxpayers filed Forms 1040 for [REDACTED] and deducted the Japanese FICA.

The taxpayers' representative provided a document written in Japanese which is alleged to be the "Social Security Act of Japan" dated May 19, 1954 (Law No. 105).<sup>3</sup> Subsequently, the taxpayers' representative provided translated portions of the document. The following are some excerpts from such translation:

#### Chapter 1 General

##### Sec. 1 Purpose

The purpose of this Act is to establish social stability and to improve welfare for workers and their survivors by providing public insurance for old age, disability, and death. This act also sets forth the

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<sup>2</sup> If the taxpayers are not classified as resident aliens for federal income tax purposes then the deduction would probably be disallowed under I.R.C. § 906(b)(1)(A).

<sup>3</sup> A written translation of a portion of the Japanese employee pension law was provided by a Chief Counsel Attorney. It is unclear whether this is the same document. The document provided by the Chief Counsel Attorney is entitled Employees' Pension Insurance Law, May 19, 1954, No. 115. Note that if this is the same Act there may have been changes to this area of the law, as the portion of the Act provided by the Chief Counsel Attorney states that the Act was revised in 1996 and 1997.

necessary rules for benefits conferred upon members of Kosei Nenkin Kikin (supplemental corporate pension plan)

#### Sec. 2 Governance

Social Security program will be governed by Japanese Government.

#### Sec. 3 Definition

The following terms are defined as indicated here.

1. Period where insurance tax is paid: as set forth by Sec. 5-2 of Kokumin Nenkin Act.

2. Exempt Period: as set forth by Sec. 5-3 of Kokumin Nenkin Act.

3. Compensation: include wages, salaries, allowances, bonuses and anything paid in exchange for the services performed by workers regardless of how it is named, excluding, however, exigency payment or payment made for the period exceeding three months.

#### Sec. 4

The power conferred upon the head of Social Security Department can be delegated to heads of local Social Security Administration Office as permitted by the regulations.

#### Sec. 6

The following office or vessel shall constitute "applicable offices."

1. The offices engaged in the following business with five or more employees:

- a) manufacturing, processing, selection, packaging, repair, demolishing
- b) construction, renovation, preservation, building repair, modification, destruction, or any incidental business thereto

- c) mining
- d) utility
- e) freight and passenger transportation
- f) shipping
- g) waste disposal, meat packing
- h) distribution
- i) financial and insurance
- j) warehousing and renting
- k) agent
- l) money collection, public relations, advertising
- m) education, research
- n) medical
- o) communication and media
- p) social work and correction

2. In addition to the above, sovereign and local government, corporation with any employee

3. Vessel owner as set forth in Vessel law

#### Sec. 9 Insured

Any person not older than 69 years old employed by applicable office shall constitute "insured."

#### Sec. 12 Exclusion

The following person cannot be treated as an insured notwithstanding the provision of Sec. 10 and 11.

1. Any employees of sovereign and local government if they are

a) public employees as defined under Public Pension Act

b) member of Kyusai Kumiai (association of common welfare) organized under the law

c) member of Private School Teachers Welfare Association organized under Private School Teachers Welfare Act

2. Temporary employees (but not those employed by vessel owner) if they are

a) employed on a daily basis

b) employed for a period of two months or shorter

3) Any person employed by the employer who does not have any fixed place of business

4) Seasonal employees (but not those employed by vessel owner) so long as such employment does not last more than 4 months

5) Any person employed by the business of temporary nature so long as such employment does not last more than 6 months

#### Sec. 13 Commencement of Insured Status

Any person treated as an insured under Sec. 9 should obtain the status of "insured" when the person becomes an employee of an applicable office, when the office becomes an applicable office after the commencement of employment, or when the exclusion status provided Sec. 12 ceases to exist.

#### Sec. 14 Termination of Insured Status

Any person treated as an insured under Sec. 9 or Sec. 10 should lose the status of insured upon occurrence of the following

1. Death
2. Termination of employment
3. Termination of status under  
Sec. 8 or 11
4. Exclusion under Sec. 12
5. 70-year old birthday

The National Office also provided a document entitled "Public Pension System in Japan," dated December 2001, issued by the Office for Planning of International Pension Affairs, General Affairs Division, Pension Bureau, Ministry of Health, Labour and Welfare. This document provides that the Public Pension System in Japan consists of a National Pension Act and an Employees' Pension Insurance Act. The following are relevant excerpts taken from the outline of the National Pension Act:

#### National Pension

National Pension was established in November

1959, as the base of the public pension system which provides insurance benefits against old-age, disability, death for all of the Japanese, in order to prevent deterioration of the stability of the livelihood of the people through national solidarity and thus to secure and improve the decent standard of living of the people.

#### Management

National pension is managed by the National Government.

#### Insured persons

All persons living in Japan (including foreigners) shall be, in principle, covered by National Pension. As a result, National Pension is a universal system for all people and provides basic pension.

##### 1. Category 1 insured persons

Persons living in Japan aged 20 and over but under 60, who are neither the persons covered by Employees Pension Insurance and Mutual Aid Pensions nor spouses of Category 2 insured persons, are categorized as Category 1 Insured persons.

(Note 1) Insured person on a voluntary basis

(1) ....

(2) ....

(3) A person living outside Japan, but who has Japanese nationality aged 20 and over but under 65.

(4) ....

(Note 2) Uncovered persons aged 20 and over but under 60

(1) Exemption from National Pension

(1) A person who meets qualifying conditions of respective old-age pension acts for the employees.

(2) A person who does not have

an address in Japan.<sup>4</sup>

(2) ....

2. Category 2 insured persons  
Persons covered by Employees' Pension Insurance or Mutual Aid Pensions are categorized as Category 2 insured persons.

3. Category 3 insured persons  
Dependent spouses of Category 2 insured persons aged 20 and over but under 60 are categorized as Category 3 insured persons.

#### Contributions

Insured Persons must pay contributions each month. Those months are recognized as insured periods.

1. Contribution of category 1 insured persons  
(1) Obligation of payment of contributions:

Persons who are obliged to pay contributions, are primarily insured persons themselves....

2. Amount of contribution

(1) National Pension is operated under the principle of "fixed contribution" and "fixed benefit."....

(2) The amount of contribution is fixed at 13,300 yen per month for the fiscal year 2001.

3. Method of contributions

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4. Contributions of Category 2 and Category 3 insured persons

For periods recorded as Category 2 insured persons and Category 3 insured persons, those persons need not pay contributions to National Pension. However, certain amount of the contributions from category 2 insured

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<sup>4</sup> Therefore, if the taxpayers did not maintain an address in Japan while employed in the U.S. they would not appear to be compelled to pay into the Japanese pension system. Thus, the payments would not be deductible.

persons to Employees' Pension Insurance is transferred to the National Pension thus the contribution from Category 2 insured persons also finances part of the budget of National Pension. In addition to this, a Category 3 insured person is required to submit an application form in order to be exempted from payment of contributions since they are supported by the employees' pension schemes.

The following relevant excerpts are taken from the outline of the Employees' Pension Insurance Act:

The Employees' Pension Insurance is a system aiming at providing insurance benefits for employees against insurance accidents such as old age, disability or death, and contributing to the stabilization of standard of living of the employees and the survivors, and the improvement of their welfare.

#### Management

Employees' Pension Insurance is managed by the Government. (Social Insurance Offices provide a range of services)

(Note)

Employees' Pension Fund - in addition to old age benefits

Employees' Pension Fund may be established by employers, who employ at least 500 persons, upon agreement of their employees and labor unions as well as upon the approval of the Ministry of Health, Labour and Welfare.

(1) All of the insured persons at workplaces where funds are established have to join the funds. Furthermore, the contribution rate for the public pension system shall be reduced in accordance with the benefits to be provided by those funds.

(2) The funds must pay benefits whose amount of benefits is at least more than the benefits under the public pension system on the basis of such reduced contribution and the contributions from the enterprises and participants.



### Insured Person

An insured person under the Employees' Pension Insurance is also covered by National Pension as a category 2 insured person, that is to say they are covered by two pension schemes.

#### 1. Scope of insured person

(1) A person under age 65 (70 from 1 April 2002) shall be compulsorily an insured person if he/she is employed at compulsorily covered workplace.<sup>5</sup>

#### 2. Types of insured persons

Under Employees' Pension Insurance, insured persons are classified into the following four categories by sex and characteristics of occupations, and treated in accordance with their actual working conditions in terms of insurance benefits and contributions.

(1) Category 1 insured persons:  
male insured persons other than miners and seaman

(2) Category 2 insured persons:  
female insured persons

(3) Category 3 insured persons:  
miners and seaman

(4) Category 4 insured persons:  
continuously and voluntarily insured persons

(Note)

Persons participating in Employees' Pension Funds are called Category 1, 2, and 3 exceptional insured persons.

#### 3. Exemption from coverage

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#### 4. Qualification and Disqualification

(1) A person becomes an insured person of Employees' Pension Insurance from the day when the person starts to be employed

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<sup>5</sup> According to a chart included under this section entitled "Chart of Covered workplace," all corporations have mandatory coverage.

at a covered workplace or the day when the person ceases to be exempted for any reason indicated in 3.

(2) An insured person is disqualified on the following day after his/her date of death, discharge by a covered workplace or falling under any of the exemptions indicated in 3.

(3) An insured person is disqualified on the day when he/she reaches age 65 (age 70 from April 2002).

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### Standard Remuneration

#### 1. Scope of remuneration under Employees' Pension Insurance Act

Under Employees Pension Insurance, earnings are classified into the following three categories:

- A. Payment for every period not exceeding 3 months - Remuneration
- B. Payment for every period exceeding 3 months - Bonus, etc.
- C. Temporary payment

#### 2. Grades of standard remuneration

There are 30 grades of Standard Remuneration ranging from 98,000 yen to 620,000 yen, which are used for calculating the amount of contributions and benefits.

#### 3. Calculation of monthly remuneration, determination of standard remuneration, etc.

##### (1) Regular Determination

The Commissioner of Social Insurance Agency determines Standard Remuneration of insured persons based on their monthly remuneration between May and July, every year ( this will be changed from April 2003 into between April and June).

##### (2) Occasional Revision

The Commissioner of Social Insurance Agency can revise the Standard Remuneration of insured persons, if the gap between average monthly amount of their remuneration for consecutive three months and his/her current Standard Remuneration becomes two grades higher or lower.

### Contribution

#### 1. Amount of Contribution

Under Employees' Pension Insurance, the amount of contribution, which can be found out from Standard Remunerations multiplying rate, shall be equally shared between employees and employers..... The following table shows the contribution rates of respective categories of insured persons:

Contribution rate from 1 April 2000  
Category 1 and 2 insured persons 17.35%  
Category 3 insured persons 19.15%  
Category 4 insured persons 7.35%

#### 2. Contribution of members of Employees' Pension Fund

With regard to members of Employees' Pension Funds, the Funds partially pay benefits of Employees' Pension Insurance, and the cost of operation for payment which is financed by contributions from members shall be exempted from paying to the government. This exempt contribution rate shall be determined by the Minister of Health, Labour and Welfare ranging from 3.2% to 3.8%.

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### Special Contribution

If an insured person receives bonuses other than earnings from their employers, one percent of bonuses shall be paid as Special Contribution which is equally shared between employer and employee.

### Types of Benefits

- (1) Old-age Employees' Pension and Specially Paid Old-age Employees Pension for persons aged between 60 and 64
- (2) Disability Employees' Pension and Disability Allowance
- (3) Survivors' Employee Pension
- (4) Lump-sum Withdrawal Benefit

### Benefits

Since insured persons of Employees' Pension Insurance are automatically covered by National Pension, when insurance accident occurs, they can also receive one of Old-age, Disability or Survivors Basic Pensions. In principle, pension benefit of Employees' Pension Insurance shall be, therefore, paid in addition to respective basic pension. Yet, there is an independent payment by Employees Pension Insurance when no pension benefit is paid by National Pension.

To further complicate matters, secondary sources provide that employers and employees are subject to a Japanese social security system composed of the following distinct elements: (1) health insurance for medical benefits; (2) Welfare Pension Insurance for pensions after retirement; (3) worker's accident compensation; and (4) employment insurance (unemployment benefits). Business Operations in Japan, T.M. Portfolio, Vol. 969 p. A-163 (April 2002); Doing Business in Japan, Price Waterhouse, 80-82 (1996); International Bureau of Fiscal Documentation (IBFD), Japan, \$ 35.1 (January 2001). It appears that the Welfare Pension Insurance component discussed in these sources relates to the Employee's Pension Insurance Act discussed above, but this is not entirely clear. See, IBDF at §§ 35.3.1-35.3.2.

### **DISCUSSION**

A resident alien of the United States, like a U.S. citizen, may claim a credit or a deduction for income taxes paid or accrued to a foreign country. I.R.C. §§ 901(a), 901(b); Treas. Reg. § 1.901-1(d); Wada v. Commissioner, T.C. Memo. 1995-241. I.R.C. § 164 provides a deduction for foreign income taxes paid. A foreign tax is a tax imposed by the authority of a foreign government or a political subdivision. Treas. Reg. § 1.164-3(d). The determination of whether the payments are taxes is based on general legal principals. Biddle v. Commissioner, 302 U.S. 573, 578-579 (1938); Dubitzky v. Commissioner, 60 T.C. 29, 33 (1973). A foreign levy is an income tax if it requires a compulsory payment pursuant to the authority of a foreign country to levy taxes, based on U.S. law, and the predominant character of the tax is an income tax in the U.S. sense. Treas. Reg. § 1.901-2(a). To the extent a taxpayer receives a specific economic benefit in exchange for a compulsory payment it will not be considered a tax, notwithstanding the foreign country's assertion that the levy is compulsory pursuant to the foreign country's

authority to levy taxes. Id.

A specific economic benefit is an economic benefit that is not available to substantially all such foreign taxpayers on substantially similar terms. Treas. Reg. § 1.901-2(a)(2)(ii)(B). A foreign levy imposed on individuals to finance retirement, old-age, death, survivor, unemployment, illness, disability benefits, or some substantially similar purpose, is not considered a requirement of compulsory payment in exchange for a specific economic benefit, as long as the amounts required to be paid by the individuals subject to the levy are not computed based on age, life expectancy, or similar characteristics of such individuals.

The employee portion of the U.S. social security FICA tax (old age, survivor, and disability) imposed under section 3101 of the Code is considered an "income tax" in the U.S. sense. Helvering v. Davis, 301 U.S. 619, 635 (1937). Employee payments made under a foreign counterpart of section 3101 are allowed as a foreign tax credit. Rev. Rul. 72-579, 1972-2 C.B. 441.

The Japanese National Pension was established to provide benefits for old-age, disability, and death. Based on the documents provided, the Japanese pension law appears to cover all persons living in Japan. Insured persons in the National Pension are classified into three categories. Category 1 insured persons are identified as all persons living in Japan ages 20 to 59 who are neither covered by the Employees' Pension Insurance or Mutual Aid Pensions, nor spouses of Category 2 insured persons. However, a Japanese national aged 20 to 59 living outside of Japan will be insured on a voluntary basis.<sup>6</sup> Category 2 insured persons are those covered by Employees' Pension Insurance or Mutual Aid Pensions. Under the Employee's Pension Insurance Act, a person under age 65<sup>7</sup> who is employed by a corporation shall be a compulsorily insured person. Further, all insured persons must pay contributions. The contributions to the National Pension are based on a fixed amount. Whereas, the contributions to the Employee's Pension Insurance are based on a percentage of wages and is shared equally between the employee and employer.

Both the National Pension Act and the Employees' Pension Insurance Act were created to provide benefits for old age,

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<sup>6</sup> This appears to be consistent with the BNA portfolio which states that Japanese nationals working in the U.S. may still be covered under the Japanese pension system if the corporation they work for obtains special clearance from the Japanese government.

<sup>7</sup> The age changes to 70 on April 1, 2002.

disability, and death. The taxpayers work for a corporation so they are compulsorily insured persons required to make contributions to the Employees' Pension Insurance. The payments are similar to the U.S. social security tax imposed pursuant to I.R.C. § 3101 which is also determined based on a percentage of employees wages. Since the employee portion of FICA is considered an income tax under the Internal Revenue Code and domestic case law,<sup>8</sup> the employee portion of the Japanese FICA should also be considered an income tax. Furthermore, the payments are not considered compulsory payments in exchange for a specific economic benefit because the contribution amounts are based on a percentage of wages, not age, life expectancy, or similar characteristics.

Our concern is whether the Employees' Pension Insurance payments are compulsory while the Japanese nationals are employed overseas. According to the response to the IDR issued by the revenue agent, such payments are compulsory. However, the translation of the Employees' Pension Insurance Act provided by the taxpayers' representative indicates that the period when insurance tax is paid is set forth in section 5-2 of the Kokumin Nenkin Act (National Pension Act). Although a translation of the National Pension Act was not provided by the taxpayers' representative, the outline of the National Pension Act provided by the National Office may shed some light. Such outline does not include the section numbers of the Act from which it is taken, thus we are unable to determine what portion of the outline corresponds to section 5-2. Regardless of which portion of the outline applies to section 5-2, according to the outline of the National Pension Act, all persons living in Japan are covered by the National Pension. Whereas, a Japanese national living outside Japan aged 20 to 59 may be voluntarily insured. This implies that for purposes of the National Pension, the taxpayers in this case would not be covered because they would be voluntarily insured.<sup>9</sup> The question remaining is whether this reasoning also applies to the Employees' Pension Insurance.

It is not clear from the outline of the Employees' Pension Insurance Act whether Category Two employees are compulsorily covered during periods when they are employed abroad. However, the outline and secondary sources explicitly state that employees

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<sup>8</sup> See I.R.C. §§ 3101 and 275(a); see also Helvering v. Davis, 301 U.S. 619, 635 (1937).

<sup>9</sup> If the taxpayers are voluntarily insured, the payments would not be considered compulsory under I.R.C. § 901 even though they are compelled to make payments as insured persons because their status as insured persons is voluntary.

covered by the Employees' Pension Insurance are also covered by the National Pension. In fact, the National Pension is considered a basic pension for such employees and the pension benefit of the Employees' Pension Insurance is paid in addition to the basic pension. There is an independent payment by the Employees Pension Insurance when no pension is paid by the National Pension. See, Public Pension System in Japan, supra at 25, 31; IBFD, supra at § 35.3.1.

*s/b "National"*  
In light of this dual coverage, it would appear that rules governing the National Pension also apply to employees covered by the Employees' Pension Insurance (or Welfare Pension Insurance). The general rule under the National Pension appears to be that a Japanese resident is not covered by the Japanese social security system if he is a nonresident of Japan. See, Public Pension System in Japan, supra at 10; T.M. Portfolio, supra at A-163. The requirement that an employer obtain a special clearance for an overseas employee in order to continue social security coverage appears to be consistent with the National Pension coverage rule. By implication this requirement would also appear to apply to a corporate employee covered by that plan under the Employee Pension Insurance or Welfare Pension Insurance.

Under this analysis, it would appear that the taxpayers at issue are not compelled to pay into the Japanese pension system while they are living in the U.S.<sup>10</sup> If this is true, the payments would not be considered a tax under I.R.C. § 901 and would not be deductible. Thus, the deductibility of the Japanese FICA depends on whether the employees of [REDACTED] are still required to make payments into the system while they are living in the U.S. and working for [REDACTED] in the U.S. In order to make this determination, we would need additional information about the Japanese social security systems (i.e., English translations of Welfare, National, and Employee' Pension Acts and an understanding of how they fit together). [REDACTED], (b)(7)a

[REDACTED]

[REDACTED]

<sup>10</sup> A secondary source seems to corroborate this position by stating that an employee could still be covered by the Japanese social security system while employed overseas if the employer obtained a special clearance from the Japanese government. See Business Operations in Japan, T.M. Portfolio, Vol. 969, p. A-163 (BNA).

We are closing our file at this time. If you have any questions or receive additional information which you would like us to review, please contact the undersigned at (949) 360-3460.

A handwritten signature in dark ink, appearing to read 'Thomas J. Fernandez', is written over a horizontal line.

THOMAS J. FERNANDEZ  
Attorney (SBSE)